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December 1988

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Gorbachev would like to hold a human rights conference in Moscow to improve the USSR's image abroad and to showcase his program for domestic reform. His recent political triumph probably provides him leeway with the more orthodox members of the leadership to satisfy some of the West's criteria for holding the meeting. At the same time, his desire to bring the Vienna meeting of the Conference on Security and Cooperation in Europe (CSCE) to a quick close to allow conventional arms talks to begin may give the West additional leverage in holding out for further liberalization of human rights.

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Moscow's much publicized concern over the need to rapidly modernize the economy and, more recently, to address consumer discontent has led many Western observers to assume that Gorbachev will have to turn to the West for major economic and financial assistance. The recent spate of credit lines linked to imports of consumer goods has served to reinforce this theory. In reality, however, the Soviet Union has reduced real imports of Western capital and consumer goods and has reduced the growth of real borrowing since Gorbachev came to power. Soviet preference for an indigenous solution to Moscow's problems and longstanding concern over becoming vulnerable to Western economic and financial sanctions, in fact, argue for a much more measured turn to the West.

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Untied loans are only a small portion of the USSR's annual inflow of hard currency and do little either to help underwrite *perestroika* or finance Moscow's overseas empire. Moreover, Moscow has the wherewithal to find alternative sources of funds should this type of lending be restricted.

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Articles

Settling the Debate on Reasonable Sufficiency

Gorbachev's UN speech on 7 December 1988—in which he announced that Soviet military forces would be reduced by 500,000 men and by 10,000 tanks, 8,500 artillery systems, and 800 aircraft—is a clear indication that the “reasonable sufficiency” debate is not being settled on the military's terms. Since mid-1979, the concept of “reasonable sufficiency” has been a subject of intense discussion among the Soviet leadership, primarily because it has come to be used as a codeword to justify cutting back on the level of resources the military receives during the 13th Five-Year Defense Plan (1991-95). The military generally opposed any cutback in military spending with the argument that sufficiency is defined in terms of parity with the West and that unilateral cuts are ill advised. Some civilians, meanwhile, were expressing the divergent view that some forces that are in excess of defensive military requirements and budgets can be cut.

The timing of the preparation for the 13th FYDP dictated that the political leadership make the decision on the appropriate level of resources for the military in late summer or early fall. Gosplan typically requires 18 months to prepare the detailed target indicators for the five-year plan and must have a draft FYDP before it can proceed. Thus, Gosplan will require the draft from the General Staff by June 1989, and to meet that deadline it needed the guidelines in terms of available resource levels in late summer or early fall of 1988.

The efforts to develop those guidelines undoubtedly produced a clash between the military leadership and its supporters and those civilians who thought the commitment of resources to the military had to be cut back. Under the aegis of *glasnost*, these academic civilians had become increasingly vocal and more unorthodox in their views. The idea of unilateral cuts undoubtedly arose with the civilians—for instance, in 1987, [

] unilateral cuts were possible, specifically citing the Soviet tank force as a candidate for such cuts. Gorbachev was clearly sympathetic to the views the civilians expressed, and he, by implication, may have encouraged their speeches and writings to see if a strong case could be made for military cutbacks. The leadership shakeup he engineered in September 1988 undercut the more orthodox wing of the party and allowed him to advance 13th FYDP guidelines that probably reflect the civilian view.

Perhaps the first convincing evidence for what these guidelines looked like is contained in a statement Marshal Akhromeyev made at an August 1988 meeting of the Soviet General Staff. Akhromeyev was addressing his staff on what must be done to implement the decisions of the 19th Party Conference. Although he defined sufficiency in the traditional military fashion, he went on to say the military

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"probably" will receive less arms and equipment. It was not clear from Akhromeyev's comment whether "less" meant less than in the current FYDP or less than the military had requested. Nevertheless, his statement does imply he knew what the guidelines of the 13th FYDP were by at least early August. His use of "probably" may have meant he saw some hope of reversing that decision but did not consider it likely.

The *Krasnaya Zvezda* article (August 1988) that reported Akhromeyev's meeting makes repeated references to the importance of emphasizing quality over quantitative parameters. Akhromeyev notes that because the combat effectiveness and quality *must* be higher it is possible for the military to receive fewer resources. The theme of quality was emphasized even more in an earlier *Krasnaya Zvezda* article written by Minister of Defense Yazov. According to Yazov, "The emphasis on quantitative parameters is becoming not only increasingly costly, but less and less effective in both military political terms and purely military terms." Gen. A. D. Lizichev, Chief of the Soviet Army and Navy Main Political Directorate, speaking at a meeting of the Directorate Party Aktiv in August, reported this emphasis on quality in exactly the same terms. It seems likely, therefore, that even if a firm decision had not been made, the military saw the handwriting on the wall.

The emphasis on quality applies not only to military hardware but also to "military science" and "composition of the armed force." A call for increased quality of "military science" means improvements in military operations and planning. Increased quality in "composition" means improved training and discipline. These two goals are the military's problem; the national economy cannot provide such improvements. Furthermore, the economy cannot easily make significant qualitative improvements in "military hardware"—weapons incorporating advanced technologies. The military leadership realizes that improvements will come slowly in this area. Thus, major improvements in quality will have to come from the military itself through more efficient planning and use of manpower.

Another indication that resources for the military were going to be scarce in the 13th FYDP and may even be cut comes from the industrial side. Lev Ryabev, Minister of Medium Machine Building, in an open press interview admitted "a number of military programs *are being cut*, and funds previously allocated for their development will be channeled toward more peaceful purposes—specifically, toward the development of machine building for the dairy industry." His ministry is responsible for nuclear weapons production.

Meanwhile, civilian academics continued to present views on the reasonable sufficiency issue that argued for major spending cuts. Perhaps the most outspoken of the critics is Alexei Arbatov, Chief of the Disarmament Section of the Institute of World Economics and International Relations (IMEMO). In a *Mezhdunarodnaya Zhizn'* article (September 1988), he suggests that reasonable sufficiency in the strategic area could be defined by a number as low as 400 1-megaton nuclear warheads. He further notes that from 10 to 20 percent of the Soviet arsenal would be adequate to impose unacceptable losses on the enemy, implying that current force levels give the Soviet Union "tremendous reserve strength." Later in the article he adds that the Soviet Union is introducing a much greater variety of models and modifications of weaponry systems [than the United States has] producing them in large batches and frequently replacing them with new models. As evidence, he quotes the December 1987 joint declaration on counting rules—it listed six US strategic weapons and 13 Soviet weapons.

While Arbatov is clearly implying that present levels of strategic weapons are more than sufficient, it is not so clear what he thinks the economic benefits would be from cutting those levels. In the article he refers to "substantial resources" that could be saved. However, in a BBC radio interview he argued that cuts in defense would not be of significant help because the Soviet economy was so inefficient it could not absorb the resources made available: "It would be like sowing seeds on asphalt."

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Arbatov has not confined himself to discussions of reasonable sufficiency. [

Other critics of the Soviet military have followed Arbatov's lead in expanding the scope of the criticism:

- Foreign Minister Shevardnadze—at a conference sponsored by the Ministry of Foreign Affairs and attended by Arbatov, a number of other academics, and government officials—spoke of the need to establish legislative oversight of the military and military-industrial authorities. The oversight would include the use of military power abroad, military construction plans, and the openness of military budgets.
- A senior researcher at IMEMO, Alexander Salvelyev, criticized the lack of new thinking in the military. He complained that, although the military had accepted deterrence concepts long ago, they were only now beginning to understand the importance of retaliatory forces on both sides.
- Several civilian writers have criticized the military's handling of its discipline problems. Even the Politburo has become involved, reportedly demanding that military leaders take measures to strengthen military discipline.

During this period, the civilians seemed to be displaying a winner's self-confidence in their discussion of the reasonable sufficiency issue. Moreover, they seemed comfortable in spreading their views to other military-related issues. At a minimum, this suggests the civilian academics were coming to believe the political leadership was leaning toward their position.

The military leadership fought back and launched a sharp counterattack against its critics. Gen. Yuriy Lebedev, of the General Staff's Legal and Treaties Department, criticized "scientists of mixed specialties" who have "only a vague idea of the subject" in an obvious reference to the academicians at IUSAC

and IMEMO. Also, the military reportedly tried to revoke the clearances of IUSAC Deputy Director Kokoshin (another civilian critic of the military) and of Arbatov in an attempt to make it more difficult for them to research military subjects. The military was overruled, however, and Arbatov and Kokoshin are free, for the moment at least, to continue to make their case for their definition of reasonable sufficiency.

The decision on unilateral cuts will affect expenditures during the 13th FYDP. Although the elimination of tanks and artillery already in the inventory will not cut future procurement, expenditures for operations, maintenance, personnel, and construction will be less. Other decisions, not yet visible, may have been made that will lower future procurement costs by altering the current pace and scope of ongoing modernization programs.

We may be able to see such changes even before the plan goes into effect because the Soviets are trying to avoid wasting resources in the future. For instance, they might not begin to deploy a weapon in numbers or locations if that planned deployment was no longer part of the 13th FYDP. There are some tenuous indications that this may have happened [

An across-the-board cut in military hardware is unlikely. In an interview with a Western reporter in July 1988, Soviet Army Gen. Vitaliy Shabanov, after claiming his country's military budget began to decline "after the start of the current five-year economic plan in 1986," went on to say that the military had

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already decided to spend more in the future on air defense, intelligence gathering, and verification of US compliance with arms treaties. Although Shabanov, Deputy Minister of Defense for Armaments, may only have been trying to affect the debate with this statement, there are some hints of its accuracy. For instance, the appearance this summer of SA-2 surface-to-air missiles (SAMs) at a number of new-generation ICBM sites suggests that the Soviets may have incurred some additional costs for air defense by deferring the retirement of older SAMs.

Nevertheless, despite some increases, it is likely that downward adjustments in the aggregate level of resources for defense are being made by the political leadership. If such adjustments are occurring as the result of a decision on the guidelines for the 13th FYDP, in addition to the already announced unilateral cuts, we would expect to see evidence of major changes in the scope of Soviet force modernization in the early 1990s.

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Soviet Proposals for Naval Arms Control: Limiting Attack Submarines

The Chief of the General Staff recently indicated that Soviet arms control policy probably will pay increased attention to seeking limits on the number of general purpose submarines, including nuclear-powered attack submarines (SSNs). Marshal Sergei Akhromeyev, in an article (*Pravda*, 5 September), not only endorsed the standard Soviet concept of geographic constraints on antisubmarine warfare (ASW) operations but indicated a desire for negotiations on limiting the size of ASW forces, especially the number of general purpose submarines. Akhromeyev stated:

We also have [quite a few at that] multipurpose nuclear and diesel-powered submarines carrying missile and torpedo arms. We are asking the United States to start talks on the reduction of the sides' naval forces. This reduction will also cover these submarines of ours.

Although Akhromeyev did not elaborate on his unusual statement, past Soviet practice suggests that he is laying the groundwork for later proposals that will be more precise. It is likely that much of the Soviet approach will be in the START context—arguing for increasing strategic stability through limits on the ASW threat to nuclear-powered ballistic missile submarines (SSBNs). Proposals for SSN limits, however, could also affect other ongoing talks, especially those involving arms reductions in Europe, as well as be part of a Soviet bid for a new set of negotiations devoted entirely to naval issues.

There probably is no single explanation for the Soviet decision to raise this issue. As in most Soviet arms control proposals, an interlocking series of motives probably is involved. They range from propaganda value through jockeying for position in negotiations to a desire to accomplish cheaply through arms control military goals that would otherwise require the allocation of additional resources to military programs.

Background

One of the themes in Soviet arms control since 1982 has been that strategic stability would be increased if each side had confidence that its SSBN force was not vulnerable to a sudden attack at the outset of war. The Soviets have often proposed to ensure this confidence through an agreement to establish zones in which each side's SSBNs could operate free of ASW activity by the other side. The conclusion of agreement on such a "confidence-building measure" would mesh neatly with Soviet naval strategy's emphasis on the SSBN bastion, whereby SSBNs are deployed close to Soviet territory and protected by defending echelons of general purpose aircraft, submarines, and surface combatants. Although they have made great strides in the development of the bastion concept, the Soviets remain concerned that Western SSNs might enter these patrol areas during a prewar period of crisis, locate the SSBNs, and be in position to destroy them at the outset of war. The Soviets have long argued for an agreement that the West would refrain from such operations in bastion areas such as the Barents Sea and the Sea of Okhotsk. The Soviets in return would agree not to conduct similar operations against Western SSBNs in areas off the US coasts. Such proposals have been ignored or rejected by the West because the net effect of such an agreement would be a substantial advantage to the Soviet Navy. Whereas the West has long posed a credible threat to Soviet SSBNs, the Soviet threat to Western SSBNs on patrol has been negligible, mainly because the Soviets lack open-ocean sensors capable of reliably locating the extremely quiet Western units.

Despite the lack of past success, the increased attention being paid to naval arms control under Gorbachev has continued to include support for

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ASW-free zones.¹ In addition to various proposals by lower ranking officials, Gorbachev himself endorsed the concept in his Murmansk speech in October 1987.

Cuts in Submarine Forces

Recent Soviet writings suggest that, in developing Akhromeyev's concept of reductions in general purpose submarines, the Soviets will use arguments similar to those used in endorsing ASW-free zones. They will stress the contribution such an agreement could make to strategic stability, particularly in a post-START environment in which the number of SSBNs had been reduced. The Soviets will argue that reductions in the numbers of attack submarines, as well as constraints on their operating areas, will support strategic stability because such submarines constitute the greatest threat to each side's SSBNs. In this regard, they probably will argue that an SSBN reduction would be similar to limits on numbers and delivery accuracy of ICBM warheads and on ABM systems as a means of bolstering each side's confidence in the survivability of its strategic forces.

Proposals for limits on attack submarines also will be presented as another way of dealing with the SLCM question, which has proved difficult to settle on the basis of limiting the number of missiles or launch tubes. The Soviets probably will argue that limiting or reducing the number of platforms should be another part of the possible solution. The Soviets regard the attack submarine as a particularly dangerous SLCM threat, in contrast to the surface ship, because of its potential for covert approach to firing positions close to Soviet territory. The issue of general purpose submarine limitations is therefore likely to be raised in the context of Soviet accusations that the United States is circumventing INF through SLCM deployments.

The attack submarine question is likely to be raised in the context of conventional arms control in Europe. Thus far, the West has been able to keep the issue of reducing naval forces out of these discussions, arguing

that the key problem is the Soviet superiority in ground forces. The Soviets, however, are continuing their efforts to turn the Western line of argument against itself. They contend that, if it is legitimate for the West to demand reductions in the Soviet forces it regards as superior and most threatening, they can demand reductions in what they regard as an area of Western superiority—naval forces. The key naval target of this line of argument thus far has been Western carrier-based aviation, but general purpose submarines would probably be drawn into the negotiations if the West eventually accepted the concept of discussing naval force reductions.

The Soviets are also likely to incorporate the attack submarine question as part of their efforts to open new negotiations devoted entirely or primarily to naval arms control. Several recent statements, including those by Gorbachev, have called for international conferences on naval arms control.

Will It Sell in the West?

Western reaction to past Soviet naval arms control proposals has been lukewarm at best, but the Soviets probably believe that this attitude is changing. Although under no illusions about the prospects for early agreement, they probably judge that, propaganda value aside, proposals for discussions of limitations of general purpose submarine forces may find a receptive audience. Among the considerations the Soviets probably are factoring into their calculations are changes in each side's perception of SSBN survivability, the possible trade-off between naval and ground forces reductions, and the possible desire to constrain naval spending.

The Soviets probably believe that the survivability of their SSBNs is improving, due primarily to the development of the bastion concept.² As the Soviets continue to introduce refinements involving under-ice operations, fixed sensors, minefields, and quieter units, they probably have concluded that the West

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Soviet Bargaining Chips: The Attack Submarine Force

The Soviet Navy views nuclear-powered attack submarines as the core of its general purpose forces. In wartime most of them would be committed to protecting nuclear-powered ballistic missile submarines (SSBNs) and attacking Western surface units, especially aircraft carriers and units equipped with submarine-launched cruise missiles (SLCMs). Others would be committed to open-ocean operations against Western SSBNs and sea lines of communication.

The nuclear-powered attack submarine force consists of about 80 nuclear-powered torpedo-attack submarines (SSNs) and 50 nuclear-powered cruise missile submarines (SSGNs), divided between the Northern and Pacific Fleets. Although three classes of SSN (Sierra, Akula, and Victor-III) and one class of SSGN (Oscar) are in series production, the force also contains many aging units constructed in the late 1950s and 1960s (see figure). Should the force be drawn into serious arms control negotiations, Soviet aims probably will involve various and sometimes conflicting objectives.

The Soviet Navy, if forced to sacrifice submarines, probably would try for numerical limitations that would give it the latitude to retire the oldest units while continuing to produce the new classes. The Soviet leadership, however, might not endorse this

approach. First, the Ministry of Foreign Affairs probably would view such an approach as hampering negotiations because of Western recognition of the minimal effect such reductions would have on Soviet naval capabilities. Second, if the political leadership's approach to the negotiations is motivated in part by economic considerations, the Soviets might be seeking constraints on the most modern units as a means of cost avoidance and consequent resource savings.

An additional complicating factor is that the Soviets, unlike the United States, also maintain an equally large force of non-nuclear-powered submarines, including some 118 operational torpedo-attack (SS) and 16 cruise missile (SSG) units. If constraints on them were not a part of the negotiations, it is likely that the Soviet Navy would attempt to expand the role of these units to compensate in part for any limitations on nuclear-powered units. Although most of this Soviet force consists of older diesel-electric units, recent technological developments have significantly increased the potential capabilities of newer nonnuclear units in terms of submerged endurance. Although they remain significantly inferior to nuclear units in sustained speed capability, advanced nonnuclear units potentially could replace SSNs in duties such as under ice operations and protection of SSBNs close to Soviet territory.

will judge that, despite continued improvements in the Western SSN force, it is becoming more difficult to locate and destroy Soviet SSBNs. Conversely, the Soviets probably hope that the West is becoming less confident of its ability to protect its own SSBNs as the Soviets continue to produce more capable SSNs and experiment with nonconventional ASW techniques.

Moscow also may hope that the West will eventually agree to pay a price in naval reductions in return for Soviet reductions in ground forces in Europe or for continuing to exclude Western air forces from the

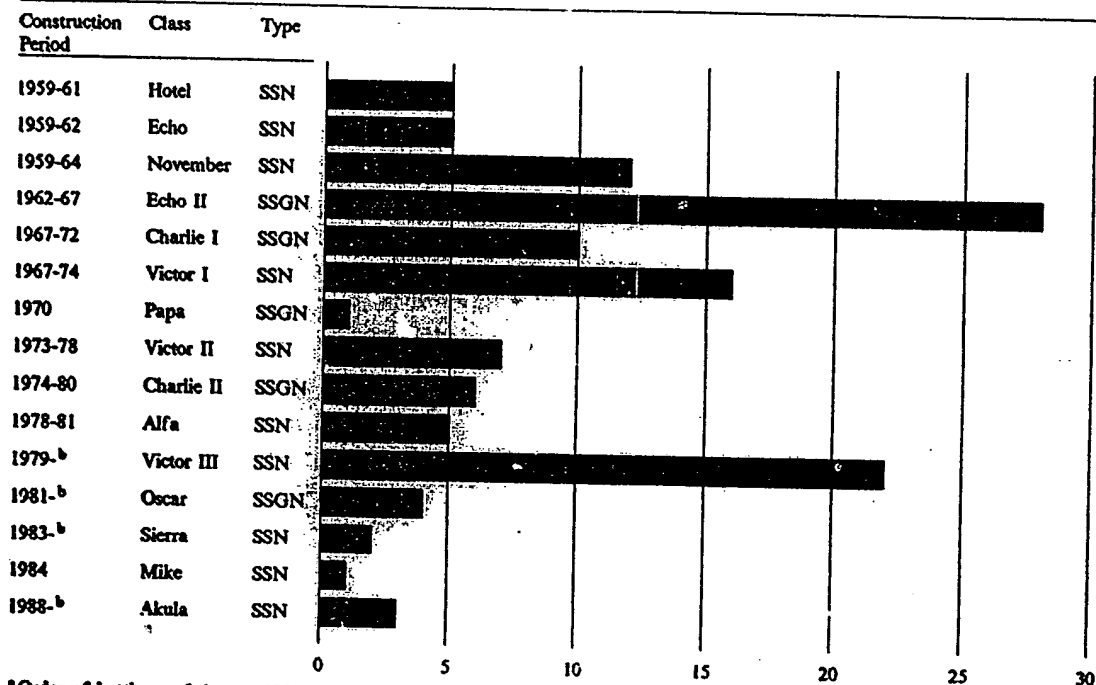
negotiations. Despite their agreement to mandate language excluding naval forces from the "Atlantic to the Urals" arms reduction talks, the Soviets may expect that tensions within NATO will lead to an agreement to have naval forces, including attack submarines, introduced into the negotiations.

Finally, the Soviets may expect a willingness on the part of future US administrations to look more closely at naval arms control as a means of controlling defense spending. The apparent abandonment of the

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Soviet Nuclear-Powered Attack Submarines ^a



^aOrder of battle as of August 1988; excludes Yankee conversion.

^bThese classes are still in production.

goal of a 600-ship navy toward the end of the Reagan administration probably was viewed by the Soviets as an indicator that even traditionally pro-navy elements in the US Government were rethinking the question of naval spending.

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The Moscow Human Rights Conference: How Serious Is Moscow?

How Badly Does Moscow Want a Conference?

Moscow has not been entirely consistent in its efforts to host a human rights conference, having alternated between periods of intense lobbying for it and periods of relative inactivity. It is currently pressing aggressively on both the human rights conference and on beginning conventional arms talks. Human rights issues are the last major obstacle to an agreement at the meeting of the Conference on Security and Cooperation in Europe (CSCE) in Vienna and must be completed successfully before the proposed Conventional Stability Talks can begin.

Tactical considerations have apparently played a major role in these cycles. After an initial push following the unveiling of the proposal, Soviet negotiators in Vienna seemed to back off and, in some cases, appeared to lack specific guidance, possibly reflecting Moscow's absorption in the INF issue and broader US-Soviet policies. When INF was largely resolved and a Washington summit put on the agenda, however, the Soviet leadership concluded the timing was right to resume a big push on the Moscow conference. As a result, Soviet diplomats in Vienna and Washington began a concerted effort to make headway on the eve of the summit.

Similarly, Soviet officials probably now sense that, with the Vienna talks winding to a close, this is their best and last opportunity to get agreement for the Moscow conference, and they have resumed intense pressure after a hiatus of several months. Since August 1988, Soviet officials, from Shevardnadze down, have dramatically stepped up the pressure. That month Shevardnadze

urged the Moscow conference idea, suggesting a trade-off for Soviet agreement to two more human-dimension conferences called for by the CSCE review document to be held in Paris and Copenhagen. In September, Shevardnadze further escalated pressure, threatening to torpedo any Western sites for followup conferences

if the West excluded Moscow. This gambit was paralleled by the Soviet representative in Vienna, Yuriy Kashlev.

Domestic political considerations apparently have also played a role. Through the hiatus during much of 1987, Gorbachev focused his attention on economic reform, possibly in the belief that his release of political prisoners then under way might be creating the preconditions for later agreement on the conference. In early 1988, when he was preoccupied with unrest in the Caucasus and political challenges from Ligachev, the impetus also temporarily slackened. However, it again dramatically picked up as Gorbachev regained political momentum.

At this juncture there is clearly an element of prestige at stake, and Moscow apparently is concerned it will lose face if it fails to get agreement to the Moscow conference. Although Moscow may at the last moment discontinue its threats to block a closure to the Vienna talks over this issue, a human rights conference retains a high priority for both domestic and foreign policy reasons. Moscow seems unlikely simply to give up its insistence on a conference at this time, but it may be willing to show considerable flexibility on the type of conference it will accept. Some evidence suggests that the Soviets could agree to any conference on the subject of "humanitarian issues," even on such topics as information exchanges, human contacts, culture, or education—that is, any usually considered a bit ancillary to the core human rights issues. A second consideration is that the Moscow conference be treated on an equal footing with any other followup conferences. Kashlev, for instance, stressed to Ambassador Zimmermann that all human rights conferences should produce a final document, or none should.

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In the final analysis, Gorbachev wants Western agreement to proceed with both Conventional Stability Talks and a Moscow human rights conference. His actions and statements on these issues suggest he does not believe he has to give up one to get the other. As a matter of tactical flexibility, he may now be willing to decouple the two issues. In fact, Gorbachev adviser Vadim Zagladin recently told a Western newspaper that the USSR no longer considered Western agreement to the Moscow conference as a precondition for concluding the Vienna talks and beginning new conventional arms negotiations. If Soviet negotiators endorse such a compromise, however, they would certainly continue to press the West for a firm commitment to the Moscow meeting almost as soon as the Vienna session ends.

The Reasons Behind Moscow's Conference Proposal

Since Shevardnadze first unveiled his proposal, Moscow has put increased emphasis on human rights inside the USSR—taking steps to implement freer emigration and more freedom of expression for those willing to work on behalf of Gorbachev's *perestroika*. Two possible hypotheses—not mutually exclusive—help explain how Soviet officials see the relationship between the reforms and the proposal for the Moscow conference:

- Soviet officials decided to implement the reforms in part to try to persuade Western countries that Moscow is a democratic and civilized Western state, which, in the words of British Prime Minister Thatcher, the West "could deal with." The conference, they hope, would showcase these reforms.
- Some Soviet leaders, including Gorbachev, may also hope to use a human rights conference in Moscow to press their reform agenda.

Human Rights Reforms Intended To Gain Western Approval. The Soviets are clearly aware of the benefits in public diplomacy they would almost certainly garner by holding a human rights conference in Moscow and exhibiting Gorbachev's reforms (emigration, legal reform, and others) to official CSCE delegates. Furthermore, the Soviets have used the West's refusal to agree to the conference to charge the West with perpetuating baseless myths about Soviet human rights deficiencies.

While the Soviets have repeatedly denied that the conference proposal is intended to score propaganda points, its timing suggests it was clearly designed to make capital with Western public opinion:

- Gorbachev apparently concluded that Soviet human rights abuses could become a major impediment to his foreign policy and arms control initiatives. At the 27th Party Congress in February 1986, he explicitly recognized this by including human rights as one of the major elements in his "new thinking."
- Economic officials apparently also believed that a general improvement in the USSR's image might pave the way for greater scientific and economic cooperation that could assist in the USSR's modernization.

Several pieces of evidence suggest that Moscow has either implemented reforms to win Western approval or has trumpeted the reforms that were under way for its own reasons to try to persuade the West to agree to the conference:

- At the very beginning of the Vienna conference, in November 1986, Foreign Minister Shevardnadze promised a more activist line on human rights—promising that Moscow would issue new laws and administrative procedures in the USSR to solve existing humanitarian issues. This came at the same time he proposed the Moscow conference.
- In October 1988, West German Chancellor Kohl announced that Gorbachev had told him that all of those considered to be political prisoners by the West would be released. Gorbachev apparently promised Kohl that he would stop the jamming of Deutsche Welle and Radio Free Europe/Radio Liberty. In the same press conference, Kohl announced West Germany's tentative agreement to attend the Moscow human rights conference.

Using the Conference To Keep "Democratization" on Track. In addition, Soviet leaders who favor greater liberalization of human rights may be using the conference to push forward their own reform agenda.

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[] Deputy Foreign Minister Adamishin has denied that Moscow wants the conference for international propaganda. Adamishin argued that the human rights conference is tied to the party congress that will be held in 1991. He has said that the leadership plans to hold the congress first and use the conference to fight conservative opposition to further liberalization of human rights. While this line is obviously self-serving, there is little doubt that, by holding out for the conference, the regime is indirectly committing itself to maintaining a higher standard for practice of human rights and, by opening itself to considerable Western scrutiny, forcing better compliance from the police and KGB.

How Much Give Is There?

Although Moscow dearly wants a conference to sanctify Gorbachev's reforms, how much further it is willing to go on human rights to get it is unclear. The regime:

- Ideally would like to showcase actions already taken, particularly those of 1987, such as the release of nearly 350 prisoners and the rehabilitation of prominent dissidents like Andrey Sakharov.
- Has recently moved a bit by releasing several individuals who fit a narrow definition of "political prisoners." (The justice minister recently said there are 11 such cases.) It has also taken further symbolic steps like allowing Sakharov to travel to the United States, hoping to get maximum mileage out of such gestures.
- Is also poised to unveil a new criminal code that will, in part, address demands to institutionalize advances in human rights by eliminating or revising particularly objectionable articles, thus bringing the USSR into closer conformity with the CSCE Final Act

While these moves are part of Gorbachev's broader domestic and foreign policy strategies—and not directly pegged to the Moscow conference—they may be timed to affect the outcome of discussions in Vienna

Despite regime interest in the conference, certain Western demands are not being met, possibly out of concern they would further erode the regime's control at a time of dramatically increased political activism, which is already challenging the party's monopoly of power:

- Apparently the regime is considering the release of only a small part of the possibly 300 to 400 dissidents still confined in prisons or asylums on a broad range of charges.¹
- Article 70 provisions against anti-Soviet activity will apparently only be made more specific, not eliminated.
- The recent Supreme Soviet endorsement of an antidemonstration law also indicates the regime feels constrained to bolster its control, despite both unprecedented opposition from a handful of deputies and its CSCE obligations to grant freedom of association and speech.

Nongovernmental Organizations: A Particularly Troublesome Issue

Access for Western nongovernmental organizations (NGOs) such as Amnesty International and the International Helsinki Federation, however, could remain the most difficult hurdle. The Soviets have continuously fluctuated on the key US demand that NGOs and unofficial Soviet human rights activists have free access to the meeting. Because the control of links between Soviet human rights activists and their Western supporters has traditionally been of supreme importance to the Soviet leadership, any greater flexibility on the NGO issue would seem to indicate an intense desire to hold the conference in Moscow.

¹ Estimates of numbers of prisoners range widely, with most in the 150-to-300 range. An accounting we completed at the end of November 1988 indicated that about 360 dissidents are definitely or probably incarcerated in labor camps, prisons, or psychiatric asylums. Contradictory or dated information precluded us from determining whether about 310 others were still incarcerated or had been released.

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How Do Soviet Dissidents View the Conference?

Soviet dissidents and refuseniks disagree over whether the West should attend a Moscow conference. Andrey Sakharov and some others believe that holding it could result in benefits, provided Moscow fulfills some preconditions:

- Almost since the Soviets first made their proposal, Sakharov has consistently expressed the view that the West should agree only if the Soviet regime releases all remaining political prisoners and grants them "social rehabilitation" (this apparently means not only their physical release but assurances that they will not be stigmatized) and if the USSR withdraws totally from Afghanistan.
- In January 1988, Sakharov expressed wariness to the US Ambassador in Moscow about Western insistence on "proper conditions" for the Moscow conference and Western pressure for higher levels of emigration. He contended that: the best guarantee for proper working conditions at a Moscow conference was Moscow's desire to avoid bad publicity in the West.
- West German Chancellor Kohl's announcement in late October 1988 that the Soviets had agreed to release all those considered in the West to be political prisoners falls short of Sakharov's first precondition. The physicist said that the mere announcement did not justify Western approval for

the conference—that "actions, not promises" are needed. Furthermore, Sakharov has implied he would not be satisfied with the release of the handful of political prisoners the Soviets claim exist; he has told the US Embassy that the 11 persons whom the Soviets claim are political prisoners excludes many whom he would consider as such

Most other Soviet dissidents have shown concern about the Moscow conference. In December 1987, Sergey Grigoryants, head of the Glasnost Press Club, told US Representative Steny Hoyer that he opposed in principle holding an official human rights conference in Moscow because it would legitimize a situation that remained unacceptable. He made this point while arguing that "democratization" had come to a virtual standstill—with almost no releases from camps or psychiatric hospitals, a sharper reaction against demonstrations, and increasing pressure on unofficial organizations. Soviet refuseniks have said in several meetings throughout 1988 that a Moscow conference would let Soviet authorities mislead the West about the extent of human rights abuses in the USSR.

The USSR's constant flip-flops suggest a continuous debate and lack of resolution among Soviet officials on what price to pay to win Western agreement to the Moscow conference.

Soviet schizophrenia about whether Western groups and Soviet activists can have free access to a Moscow conference became evident immediately after Shevardnadze made his proposal. In December 1986, when asked whether groups like Amnesty International would be allowed to participate, Kashlev said it would be subject to negotiation. However, he continued, "I do not know Amnesty very well, but I know

many groups that in reality have nothing to do with human rights but with intelligence services."

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By the fall of 1987, however, there seemed to be some backtracking or uncertainty, perhaps stemming from the more assertive behavior of Soviet human rights activists. The informal human rights seminar organized by the *Glasnost* Press Club, only several weeks before the Washington summit, made the question an immediate, rather than academic, concern:

- [] reported to the US CSCE delegation in October 1987 that a Soviet official told [] that groups "interested in the CSCE process" would be welcome, but not groups that were "provocative." He used the *Glasnost* Press Club as an example of a group in the second category.
- That month, an aide to Kashlev told a seminar organized by the International Helsinki Federation that foreigners, except those who were on a Soviet lookout list, would be welcome at the Moscow meeting.

The Soviets were well aware of intense Western interest in the unofficial seminar; at a plenary meeting in Vienna, Ambassador Zimmermann expressed support for the coming *Glasnost* Press Club seminar as well as a subsequent International Helsinki Federation visit to Moscow. Ambassador Zimmermann emphasized that Soviet treatment of these meetings would be watched closely and would be a test of Moscow's acceptance of monitors as generally understood in CSCE language. As a result, Moscow apparently decided the foreign policy gains outweighed potential domestic risks:

- After several weeks of vacillation and mixed signals, a nonpaper on the Moscow human rights conference given on 2 November by Soviet Ambassador Dubinin to Assistant Secretary Ridgway said that the Soviets had clarified the issue of access to Moscow for NGOs, groups involved in protecting rights, and private individuals. The nonpaper noted that Moscow proposed to open all plenary meetings of the conference—"which has never been done at any CSCE forum."
- The *Glasnost* Press Club conference was allowed to convene with minimal regime interference in December.

- In January 1988 the regime grudgingly gave way on demands for participation by Grigoryants and other former prisoners in a landmark meeting between the Soviet quasi-official CSCE commission and the International Helsinki Federation—the first official NGO to visit Moscow.

In 1988, Soviet officials have not raised the NGO issue with anything like the frequency that was evident in late 1987. In a July 1988 session, Kashlev noted that, while he did not like "preliminary conditions," the precedents in CSCE documents regarding openness and access would be met. Despite this and other generally positive signs, the obvious political sensitivity of allowing Western human rights observers and former Soviet citizens, long castigated as anti-Soviet elements, to visit Moscow to scrutinize Soviet human rights performance suggests this issue might crop up as a last-minute hurdle to the conference.

The Leadership Angle

We do not have any direct reporting that indicates that the Moscow human rights conference has been a serious issue inside the Politburo. It is reasonable to assume, however, that the various leaders might very well disagree on this matter. Although even the conservatives in the leadership would agree that Moscow should get any benefits from public opinion it can from hosting a conference—Ligachev has, in fact, publicly made this point—they are much quicker to sound the alarm over the dangers of foreign influences, most clearly represented by the presence of NGOs like Amnesty International, whose presence would stir up an already boiling pot.

The positions various leaders have taken on issues, such as human rights demonstrations, *glasnost*, nationality unrest, and "democratization" in general, permit us to assume that Gorbachev, Yakovlev, Shevardnadze, and, perhaps, ideology secretary Medvedev favor the initiative to hold a human rights conference in Moscow. They probably see it as a way to demonstrate to the Soviet public, as well as to their more orthodox colleagues on the Politburo, the need

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to continue to institutionalize political and legal reform. The institutional role of Foreign Minister Shevardnadze would make him a natural proponent of the idea, and he has been the front man in Soviet efforts to gain agreement to the conference.

On the other hand, Ligachev, Chebrikov, and Shcherbitskiy are probably leading the forces in the Politburo that question the wisdom of opening the country to foreign monitors of human rights. Former KGB chief Chebrikov—now a senior party secretary formally tasked with overseeing administrative organs and legal reform issues—has made several hardline speeches concerning the need to manage democratization. He is anxious to ensure that reforms do not get out of hand, present opportunities to Western intelligence services to operate within the USSR, or encourage political instability. Such statements clearly suggest he would be among those least enthusiastic about a Moscow human rights conference that would grant Western human rights groups an occasion to strengthen their contacts with Soviet political dissidents, many of whom have been in the forefront of growing nationalist and popular front movements. Similarly, Ligachev's condemnation in July 1987 of the "scum and debris" that washed up with the waves of restructuring and renewal strongly suggests he would also be unenthusiastic. Likewise, Ukrainian party boss Shcherbitskiy has recently gone on record with strong criticism of the abuses of reform by former dissidents. He has indicated intense concern about nationalist activity in his republic, explicitly criticizing former Helsinki monitors who were freed in Gorbachev's initial wave of released political prisoners in 1987. These leaders' views appear to be shared by many local party officials and Central Committee members, as indicated by the strong support for recent curbs on public demonstrations and periodic tough crackdowns on activists in several republics.

Despite little direct evidence, Shcherbitskiy's concerns may be shared by the other two regional party leaders on the Politburo, Moscow chief Zaykov and Leningrad First Secretary Solov'yev, a candidate member. Concern about a growing spiral of demonstrations has led them to take a tougher line with activists, particularly in Leningrad. Moreover, their cities would clearly be focal points of attention during any conference,

undoubtedly causing them untold headaches. Several reports and their public statements suggest that both men are concerned about the burgeoning informal groups and journals, and Zaykov has expressed worry about how reform has contributed to nationalist activism.

A large middle ground of Politburo officials may end up being influential in the decision on how far to push for a human rights conference. This group includes Premier Ryzhkov, party secretaries Slyun'kov and Nikonov, and government officials such as Gosplan chief Maslyukov, deputy premier Biryukova, and Talyzin—who all are focused primarily on economic issues. While they probably lack the expertise or deep commitment to the issue, they may be tempted to accede to Gorbachev's interest in the conference as a way of improving the climate for East-West trade, which does relate directly to their formal responsibilities.

These crosscutting equities make Moscow's bottom line difficult to predict, but it appears that Gorbachev's recent leadership shakeup and his assumption to the presidency give him greater room for maneuver, which may help explain the latest push to gain Western acceptance for the conference.

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The Soviet 1989 Economic Plan: Can Gorbachev Keep His Promises to the Consumer?

The 1989 plan, announced at an October meeting of the Supreme Soviet, substantially elevates the priority of consumer welfare but, in our judgment, does not supply sufficient resources to back up the planned production of goods and services. Priorities within machine building and investment are being refocused to concentrate resources on key technologies and consumer welfare programs. Moscow's promises are largely predicated on unrealistic targets for economic growth and resource savings. Moreover, Moscow's approach could make matters worse—increased spending for consumer welfare is contributing to substantial growth in the state budget deficit, and managers are expected to meet ambitious production targets while accommodating numerous, probably disruptive, changes in the economic system. Shortages of consumer goods and inflation may well increase, potentially fueling popular unrest.

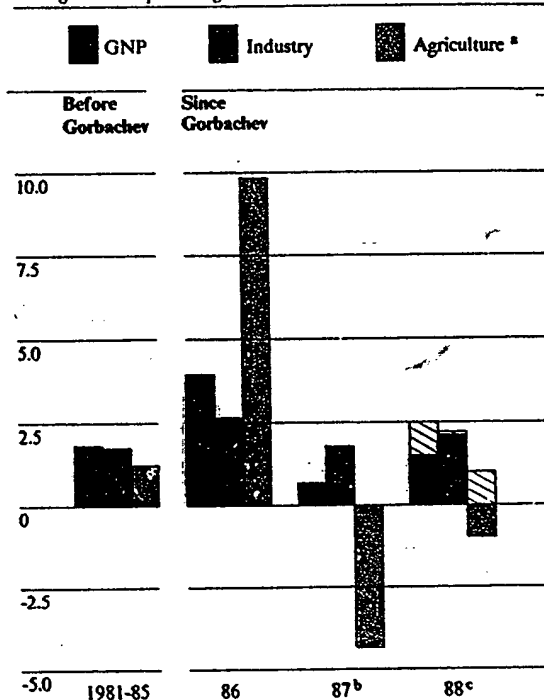
Growing Concerns in 1988

Soviet officials and analysts have expressed growing dissatisfaction with the performance of the economy. In 1988 the Soviet economy will rebound from the extremely poor showing in 1987, but growth will fall far short of targets set for 1988 in the 12th Five-Year (1986-90) Plan (see figure 1). Demands to increase output, while retooling and implementing new economic and managerial measures, are probably taking an increasing toll on performance in many industries. We estimate total industrial output will grow by about 2 percent in 1988, with even slower growth in chemicals and metals production. Agricultural output is likely to grow by less than 1 percent, as declines in crop production are balanced by gains in production of meat, milk, and eggs.

Ambitious Soviet targets are spreading resources too thinly and thus diluting their impact on economic performance. Plans to increase spending in such areas as science, consumer services, and hospitals are probably on target but state revenues have grown much slower. Consequently, Soviet officials have to contend with a large and growing budget deficit and rising

Figure 1
USSR: Economic Growth, 1981-90

Average annual percent growth rates



^a Net of feed, seed, waste, and purchases from other sectors.

^b Preliminary.

^c CIA projection.

inflationary pressures. Likewise, investment growth will be about 5 percent over 1987, but this spending is not being assimilated effectively. The rate of housing completions has fallen, and growth in commissionings of new plant and equipment through the first nine months of 1988 is less than 3 percent.

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The lack of improvement in consumer welfare has drawn particular criticism. For years, output of producer goods has grown faster than consumer goods, and the Soviets have favored heavy industry with investment resources. Since 1985 the Soviets have relied on stricter quality control and management reforms in light industry and retail trade to improve consumer satisfaction, but these have failed to produce significant results. Although some gains have been made in housing and consumer services, overall per capita consumption has stagnated, and inadequate food supplies have become—according to Gorbachev—the most pressing concern on Moscow's agenda.

Moreover, Gorbachev's reforms have in some ways worsened the situation. A wage reform has contributed to a rapid increase in nominal wages that has exceeded growth in the supply of goods and services (see figure 2). Many enterprises have used their new freedom to plan output by dropping or reducing production of unprofitable, usually low-priced consumer goods. Wholesale trade reforms have started to disrupt established channels of distribution. For all of these reasons, according to Soviet officials and press accounts, shortages have intensified, and inflation in the markets for consumer goods and services is on the rise.

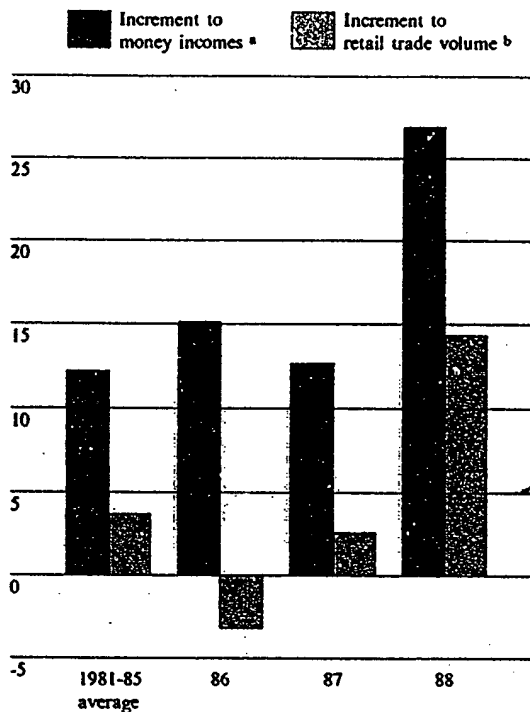
The 1989 Plan: Shifting Priority to the Consumer

The 1989 targets for industrial production have been lowered somewhat from the original goals of the five-year plan. Nevertheless, targets for industry and the rest of the economy remain ambitious, especially given 1988 performance (see table). Investment growth is planned to slow, consistent with the original five-year plan. Adverse conditions in international markets, primarily weak energy prices, have forced Soviet planners to scale back nominal targets for foreign trade from the 1988 plan goals by 2 percent. Gosplan chief Maslyukov indicated after the Supreme Soviet meeting that the volume of trade will increase, but he did not provide details on the structure of imports and exports.

New Priorities. Soviet planners have clearly departed from the original 12th Five-Year Plan by setting across-the-board increases in production targets for consumer goods and services. Production of consumer

Figure 2
USSR: Change in Disposable Income
and Volume of Retail Sales

Billion rubles



^a CIA estimate.

^b Official Soviet sales data in current rubles; deflated using CIA's estimated retail price index.

goods is slated to grow by 7 percent rather than the original target of 5.7 percent. Retail sales of consumer goods are to rise 6.1 percent over the plan target for 1988, and services, 8.1 percent. Spending on housing, education, the environment, pensions, and other social services will also be increased. To meet longer term goals for food and nonfood consumer goods, large increases in investment in food processing and light industry are planned.

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USSR: Key 1989 Economic Goals

Percent

	Increase of 1989 Plan Over 1988 Plan ^a	Increase of 1989 Plan Over 1988 Performance ^b
GNP	4.5	10
Agriculture	2.0	7
Industry	4.0	11
Machinery ^c	6.0	26

^a Official plan goals based on gross value of output.

^b Based on CIA estimates of production in 1988.

^c Civilian and defense machinery.

Almost all sectors of the economy are to contribute to these efforts to raise consumption:

- The defense-industrial ministries have been tasked with major increases in the production of such prestigious consumer durables as color TVs, VCRs, and PCs, and are to increase production of equipment for food processing and light industry by 25 to 30 percent.
- Deliveries of timber and other construction materials to retail sales are planned to increase by 15 percent over the 1988 plan in order to support private housing construction and remodeling, especially in rural regions.
- The transport sectors are being asked to increase the volume of passenger transport by 5.5 percent for air travel and 4 percent for train travel over the 1988 targets. Freight shipments are to increase by 2.6 percent.
- Even the hard-pressed energy sector is being told to increase deliveries of fuel over the five-year target for consumer and municipal use.

By contrast, overall production of producers' goods is slated to grow by 3 percent over the planned level for 1988, rather than the original target of 4.5 percent. Output in the machine-building complex is to grow at

6 percent, including 9 percent for high-technology sectors, and improvements in machinery quality continue to be stressed. While modernization goals remain ambitious, the Soviets are now emphasizing key areas rather than pursuing across-the-board growth. According to Maslyukov, the basis of the plan for machine building is 44 priority areas for technological development, of which at least 16 are intended to modernize consumer industries. More generally, output of equipment for consumer-related and high-technology industries is slated for large increases.

The 1989 plan calls for slow growth of most industrial materials, with the focus on improving the composition of output in metallurgical, chemical, timber, and construction materials industries. Output of oil, gas, and coal is to grow by roughly 3 percent—an upward revision from original targets, reflecting the resignation of the leadership to slow growth in energy conservation and continued reliance on energy products for export earnings. Likewise, planned output of rolled ferrous metals has been increased above original targets for 1989 but still at a relatively slow rate of growth.

Finding the Resources

Moscow is counting on more efficient use of resources to meet most of the 1989 plan targets. Given the failure of the economy to meet resource-savings targets in 1986-88, 1989 targets are probably unrealistic. According to the 1989 plan, resource savings are to account for 100 percent of the increased demand for metals and timber products and 70 percent for energy products. Soviet officials have been harshly critical of the waste of investment resources, especially in the agroindustrial complex, and the 1989 plan appears to be counting on the reduction of unfinished construction to compensate for a more stringent investment policy.

Reforms. Soviet planners are counting on continued gains in efficiency from the further implementation of economic reforms in 1989. All of industry and agriculture will make the transition to self-financing by the first of the year, and wholesale trade reform will

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continue to expand. State orders are to be reduced by at least 50 percent in industry, although certain "unprofitable" consumer goods remain tied 100 percent to state orders to ensure that they will be produced. Neither wholesale nor retail price reform is scheduled for implementation in 1989. It is likely that retail price reform has been postponed indefinitely; even reform economists are now expressing skepticism about its wisdom.

The Soviet leadership is pushing forcefully for the expansion of the private and cooperative sectors and long-term leasing arrangements in both agriculture and industry because these initiatives hold the best prospects for producing short-term improvements in the quality of life:

- During the debate on the 1989 plan, officials of the agroindustrial complex were criticized for failing to take full account of the potential of cooperatives and leasing for expanding output in the formulation of the plan for the complex.
- Converting enterprises to cooperatives or lease arrangements is routinely mentioned as a solution to unprofitability.

Meanwhile, Soviet leaders continue to place high hopes on Intersectoral Scientific and Technical Complexes to overcome barriers to technological innovation and to speed up modernization.

Reallocation. Maslyukov, in his report on the 1989 plan, indicated that resources are to be diverted from unspecified producers and exports to meet consumer welfare goals. Given the thrust of the 1989 plan, it is fair to assume that heavy industry will bear the brunt of any transfer of resources. Nonpriority machine-building sectors are the most likely targets for cut-backs in resource allocations. According to a deputy chairman of Gosplan, 260 industrial enterprises are to be fully or partially converted to production of goods for the consumer.

Well-endowed Soviet defense industries have been directed to reequip food-processing and consumer goods enterprises, and they indeed have inherited many plants from a disbanded ministry that was

charged with manufacturing equipment for the production of consumer goods and food. The Minister of Medium Machine Building, the most secretive of the defense ministries, indicated in a recent interview that a number of military programs are being cut and that two enterprises designed for the production of military hardware will be converted to civil production. Gorbachev, in his recent UN speech, also emphasized the need to convert some weapons production capacity to civil uses. But, at least through this five-year plan, defense industry participation is likely to remain limited, because Gorbachev is probably reluctant to disrupt major weapon development and production programs that are key to force modernization.

Investment resources are being redirected to sustain improvement in consumer welfare into the 1990s. Investment for housing and other social purposes is to increase 7.4 percent, while productive investment in industry and other sectors will remain at "roughly the 1988 level." Productive investment, in turn, is being shifted to the narrower priorities for developing machine building and to meeting consumer welfare targets.

Foreign Trade. With a planned drop in turnover in 1989 from the 1988 plan levels, foreign trade is not likely to play much of a role in increasing the availability of capital equipment, industrial inputs, and consumer goods. Soviet export earnings will be hurt by soft energy prices and the chronic uncompetitiveness of Soviet manufactured goods on world markets. Concern expressed during the Supreme Soviet debate over the draft plan led Moscow to reduce export plans for tractors, other agricultural machinery, and, perhaps, even some fuel so as to increase availability to Soviet agriculture.

Imports are to be channeled preferentially to consumer goods industries, but with no increase in overall imports; this requirement implies that other sectors will experience decreases. Imports from Communist countries are to help support an increase of 30 percent in equipment to be applied to retooling of light

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industry. Recently signed lines of credit with Italy, West Germany, and the United Kingdom for purchase of light industry and food-processing equipment suggest that increased imports of these items could begin as early as 1989, although most such imports will occur in the 1990s. Moscow's reluctance to increase its hard currency debt, fueled by doubts about its ability to increase hard currency exports, suggests that it will draw down these credits slowly.

Prospects

The Soviets are unlikely to come close to meeting their ambitious output targets, especially for consumer goods. Leadership adherence to the high-growth targets of the 12th Five-Year Plan allows little slack for enterprise managers to adjust to reforms and to restructure production to meet the higher priority attached to consumer welfare. Moreover, while probably balanced on paper, the plan relies heavily on large gains in efficiency and resource savings, going beyond the traditional tautness of Soviet plans. As a result, the plan does not appear to provide adequate resources to meet even priority targets. Several of the speakers at the October Supreme Soviet session complained that the 1989 plan was not backed up with the needed material support.¹ The inability of Soviet planners to develop an achievable plan will increase the gap between incomes and available commodities, adding to inflationary pressures (see inset, "Coping With Inflation").

Moreover, the changeover to the new economic mechanism, if fully enforced, creates the potential for serious disruptions to economic performance in 1989. Enterprises are being asked to finance their own expenses, including investment, out of profits and to negotiate directly with suppliers and customers, which might interrupt traditional supply relationships. Moreover, planning authorities and ministries have less control over enterprise activity if things start to go awry. Output targets passed down from Gosplan are nonbinding, except for output covered under state orders (see inset, "Declining Authority of Central

Coping With Inflation

The wage inflation resulting from greater enterprise control over labor payments and from the wage reform seems to have taken Moscow by surprise. Plans for dealing with it are sketchy and unpromising. Central bank authorities are to monitor increases in wages to ensure that increases in productivity exceed wage increases. The Soviets may also be attempting to slow the pace of the implementation of the wage reform; so far no targets for further expansion in 1989 have been announced. Moscow, however, may have little choice but to proceed so as to prevent unwanted labor movements into those enterprises that have already adopted the higher wage scales of the reform. Moreover, until Moscow comes to grips with other factors contributing to inflationary pressures, administrative efforts to control wage increases are not likely to have much impact on general inflation in the economy.

In particular, Moscow's inability to issue a balanced plan will add further to inflationary trends in 1989. Some expansion of consumer programs is being financed with a sharp increase in government spending that officials must recognize is not backed with the necessary goods and services. Finance Minister Gostev reported in his speech on the 1989 budget that expenditures would rise by 11.5 percent (50 billion rubles) and revenues by 3.3 percent (15.6 billion rubles), leading to a deficit of 35 billion rubles. By contrast, we estimate that the deficit equaling about 80 billion rubles in 1988 will approach 125 billion rubles in 1989. Measures to address the deficit—increasing enterprise profits and reducing expenditures on management in government and industry—are almost certain to be inadequate. Indeed, Maslyukov asserts, "I don't think that the growth of inflation will slow down or come to a halt. A certain period of time will no doubt elapse before we manage to cope with this problem."

¹ Some basis for these complaints lies in the traditional haggling that generally goes on behind the scenes and unfamiliarity with new forms of planning and distribution

Declining Authority of Central Planners

Moscow's ability to control the direction of the economy has waned as the economy has grown more complex. Gorbachev's economic reforms and overly ambitious five-year-plan targets have intensified this trend. The discussions leading to the adoption of the 1989 plan were marked by intense dissatisfaction over the lack of progress in directing resources to meet priority targets, especially for light industry and the agroindustrial complex. At one point during a Council of Ministers' meeting in mid-October 1988, Ryzhkov interrupted a speaker who was explaining the reasons for price increases by saying "How could this happen? Isn't there any control at all in our country?" Frustrated by the negative consequences of economic reform that developed this year, Moscow has implemented several administrative measures that clearly contradict the spirit of the reform efforts.

The leadership's frustration is likely to grow in 1989 as reforms are expanded. Ministries have been specifically forbidden to add to Gosplan-issued state orders or to force enterprises to sign contracts. The head of the State Committee for Material and Technical Supply stated at the September meeting of the Council of Ministers that some enterprises and ministries were actually planning lower output levels for 1989.

In addition, the role of central planners is also being challenged by a more active Supreme Soviet. Gosplan Chairman Maslyukov claimed that—"unlike past years"—proposals made by the Supreme Soviet's reviewing commissions had resulted in a number of important changes in the draft plan, including:

- An increase of 6 billion rubles in the target for sales of consumer goods.
- An increase of 1.3 billion rubles in capital investment in the agroindustrial sector (at the cost of investment cuts in other unspecified sectors).
- An increase of 200,000 square meters in the target for housing construction.

The Supreme Soviet also is beginning to openly discuss previously taboo subjects. It has talked about the budget deficit for the first time, and there have even been calls for an open examination of the defense budget. Probably the most startling development at the late October session of the Supreme Soviet, however, was the announcement of the recorded votes on a number of issues, which for the first time in recent history were less than unanimous.

Planners"). More enterprise autonomy is a risky move because key economic information, especially prices, has not yet been adjusted to ensure that an enterprise's decisionmaking is consistent with state goals. In 1988, for example, many enterprise managers under self-financing have focused on production of higher priced goods and have allowed wage increases to outpace increases in productivity.

While the leadership has not backed off from the high-growth strategy set in the 12th Five-Year Plan and no doubt hopes for the best, it may be bracing itself for a rocky road. A leading reform economist has recently commented that the five-year plan is

incompatible with the switch to the new economic mechanism. In an article on the draft plan, a deputy chairman of Gosplan stressed the importance of quality over quantity and seemed to imply that achievement of output targets was not expected. Finally, Maslyukov in his address to the Supreme Soviet only "hopes" that proposed energy targets can be met and admitted that the plan will not eliminate shortages of consumer goods. Another official went even further, saying in a speech to the Supreme Soviet that the acceleration of production of consumer goods will have "virtually no effect" on pent-up demand.

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At the same time, insistence on pursuing unrealistic targets increases the prospects for economic disruptions. In contrast to previous five-year-plan periods, the leadership generally has not used the annual plans to account and to adjust for the economy's failure to meet its targets in previous years. The 1989 plan, therefore, may serve only to exacerbate the disproportions accumulated to date since Gorbachev's accession. In addition, planners are attempting to superimpose changes in the economic mechanism, including the planning process, which, at best, were ill-defined notions when the plan was being drafted. Should the leadership manage to maneuver the economy through this transitional period without resorting to administrative measures to overcome every obstacle, then Moscow's chances for improving the performance of the economy in the long run will be improved.

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Soviet Dependence on Imports From the West: Why the Numbers Belie the Rhetoric

Moscow's much publicized concern over the need to rapidly modernize the economy and, more recently, to address consumer discontent has led many Western observers to assume that Gorbachev will have to turn to the West for major economic and financial assistance. The recent spate of credit lines linked to imports of consumer goods has served to reinforce this theory. In reality, however, the Soviet Union has reduced real imports of Western capital and consumer goods and has reduced the growth of real borrowing since Gorbachev came to power. Soviet preference for an indigenous solution to Moscow's problems and longstanding concern over becoming vulnerable to Western economic and financial sanctions, in fact, argue for a much more measured turn to the West.

Perceptions and Reality

There has been much discussion both inside and outside the Soviet Union regarding Moscow's need for substantial imports of Western equipment, technology, and consumer products. Debates initially focused on the role of Western technology and equipment in Gorbachev's economic modernization program. They have subsequently broadened to include those consumer goods and services necessary to legitimize Gorbachev's regime—and his program of *perestroika*—among rank-and-file Soviets.

In Western circles, such discussions are often a critical element in the larger debate over the appropriateness of "helping" Gorbachev solve his domestic economic problems. Although there may be wide disagreement over what the West should or should not do in this regard, there seems to be a consensus within political and media circles that Moscow will rely heavily on the West and that the Alliance should take steps to ensure that it does not inadvertently provide Moscow with substantial economic and military dividends by competing for Soviet business.

Gorbachev and his economic brain trust have not discouraged Western perceptions of a Soviet need for massive inflows of Western equipment, technology, and consumer products. Economic imperatives aside, it serves Moscow's broader national security objectives to have Western governments "vested" in a positive outcome of the regime's economic and political reform efforts. Discussions of major joint-venture arrangements with Western firms contain elements of such vesting. This tactic seems most evident, however, in Moscow's recent successes in landing the official blessings of West European governments for the extension of large credit lines to underwrite Soviet purchases of equipment in support of domestic efforts to improve consumer welfare.

Western expectations of increased Soviet economic dependence, however, contrast sharply with actual Soviet behavior: trade and financial data demonstrate that, if anything, Moscow has become more autarchic under Gorbachev:

- Once one discounts for exchange rate movements, net indebtedness has risen by only 16 percent since 1985; net real borrowing actually fell by \$1.5 billion last year.
- Soviet imports of Western capital goods have fallen in real terms since Gorbachev came to power; although attention has recently been given to establishing credit lines to underwrite future imports, there are no signs of a substantial upswing in actual orders. The 1989 Soviet Economic Plan, for its part, calls for a slight fall in total Soviet imports.
- The leadership cut back substantially on imports of consumer goods in response to falling export earnings, and imports have yet to return to pre-1985

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levels despite the increased saliency of improved consumer welfare to the success of *perestroika*. Austrian companies, for example, complain that sales of shoes and clothes to the Soviet Union—more than \$100 million in 1984—have almost evaporated.

Understanding Soviet Behavior: Past Lessons . . .

Moscow's reluctance to turn to the West for substantial help is better understood when one considers the nature of economic problems facing the Soviet leadership and the broader implications of economic integration for Soviet national security objectives.

The leadership has undoubtedly drawn a number of sharp lessons from Brezhnev's experience in the mid-to-late 1970s:

- The emphasis on Western technology and equipment as a means of stimulating and leading economic modernization did not live up to its advance billing. While certain sectors—petrochemicals, automobiles—benefited from Western assistance, the overall record reveals a pattern of equipment and technology purchases that were inappropriate to begin with, never properly installed, or, even in the best of circumstances, utilized effectively.
- Expanded trade with the West paid political dividends by engendering potentially divisive competition within the Alliance for Soviet business, both in terms of heavily subsidized credits and pressures to relax guidelines of the Coordinating Committee for Multilateral Export Controls (COCOM). At the same time, the subsequent application of economic sanctions to modify Soviet domestic and foreign policy initiatives made the cost of economic dependency abundantly clear to Brezhnev and his successors.

The leadership has paid close attention to the economic and political problems faced by those East European countries that were unable to make good on the gamble of using Western equipment and technology to jack up economic performance to a higher plane:

- While some improvements occurred, the East European experience demonstrated that the sought-after technological and economic gains simply could not be achieved within an economic environment characterized by central plans and administrative economic decision making.
- The price for this failure—economic austerity at home and a pronounced dependency on the good will of Western lenders—is still being paid. In some cases, it is at the heart of political dissatisfaction within Eastern Europe.
- Soviet concern with avoiding similar mistakes is captured in a recent interview by the Minister of Light Industry, who stated that Moscow had decided “categorically” against instant gratification: “That path has no future in it . . . and the Soviet Union will never be able to get out of [such a] dependence on buying.”

. . . Current Realities

Gorbachev's economic advisers also recognize the potential gains from increased use of Western technology and equipment, but they lack the confidence in the ability of the economy—as currently configured—to effectively absorb and ultimately diffuse imported technology on a large scale. They are specifically sensitive to the incongruence between current administrative rules and incentives governing enterprise performance and the competitive economic environment (price flexibility, decentralized decisionmaking, competition for sales) needed if the USSR is to draw effectively on Western technology and equipment:

- Firms lack the ability to bid for domestic resources or otherwise elicit timely domestic machine-builder response to their particular requirements. As a result, enterprises have a distinct bias toward imported equipment—which can be tailored to individual specifications and delivered on a timely basis—even when the same or similar equipment is produced domestically.

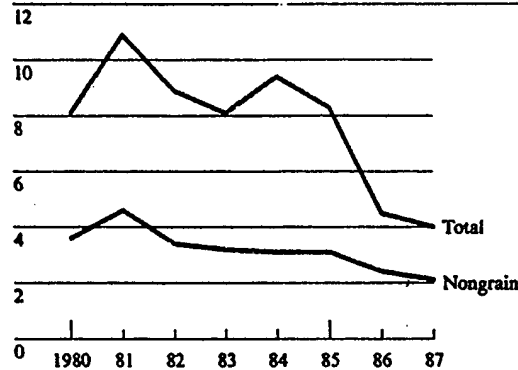
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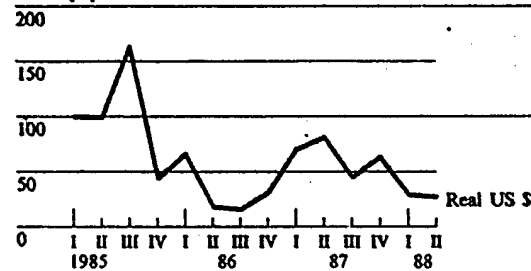
Soviet Conservatism Is Seen In The Decision To...

Reduce Imports...

Hard Currency Imports of Consumer Goods, 1980-87 Billion US \$

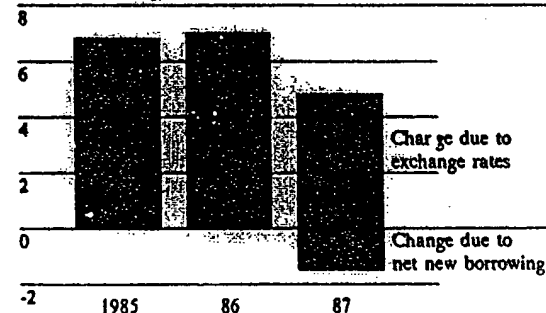


Orders of Western Machinery and Equipment, 1985-88 Index: 1985I=100



...Rather Than Increase Debt

Estimated Change in Gross Debt Billion US \$



- Firms are not held fully accountable for the effectiveness of their import decisions. In the absence of an incentive structure to reward proper choices and effective absorption or, conversely, to penalize those who pay little attention to what is purchased and how and when it is installed, there is little guarantee that scarce foreign exchange will be well spent.

Steps have been taken to facilitate direct contacts between Soviet enterprises and Western equipment suppliers and to properly reward effective decision-making. At present, however, Soviet enterprise managers are faced with the worst of all worlds: the old rules governing the selection and purchase of imported equipment have been remanded for many enterprises and ministries, but Moscow has yet to fully develop the sets of procedures to take their place. This confusion, combined with the uncertainties regarding the implications of imported equipment for self-financing, product pricing, and the generation of hard currency export earnings, may well have resulted in an aggregate decline in enterprise demand for imported equipment. While some of this decline is entirely appropriate for the reasons cited, enterprise confusion has probably resulted in a suboptimal level of equipment imports over the near term.

Import demand is also constrained by Soviet financial conservatism. This leadership, like those before it, is sensitive to the national security implications of becoming financially overextended. A number of leading Soviets have been particularly explicit on the need to avoid any semblance of dependence on Western financial markets to meet domestic economic imperatives. Any Soviets who doubt the rationale behind this line of argument need look only at the experience of Eastern Europe, the past imposition of economic sanctions, and the persistence of those who seek to monitor and condition credit flows. This conservatism—manifest in a low level of indebtedness, a substantial "strategic reserve" of gold, and a high level of liquid asset holdings in Western banks—argues against a rapid rise in borrowing unless the ability to repay this debt is fully guaranteed

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In this regard, the situation facing Moscow in 1988 is far different from the USSR's position in the early-to-mid 1970s, when the Soviets allowed their debt to the West to increase substantially:

- Brezhnev's economic advisers were confident of the Soviet ability to repay a significantly higher level of debt with higher priced oil and other natural resources. In 1988, in contrast, Moscow must contend with stable or declining oil prices and uncertainties over the quantity of oil that will be available for export. The leadership is painfully aware, moreover, that substantial hard currency sales of manufactured goods are not in the cards for the near future.
- Much of the debt runup in the 1970s was formally tied to Western agreements to purchase Soviet raw materials, notably Siberian natural gas, coal, and wood products. In all cases, the flow of hard currency earnings far exceeded project-associated hard currency expenditures, guaranteeing the Soviets an increase in hard currency import capacity. Although similar deals cannot be ruled out in the 1990s, there are few indications that this option is being heavily pushed.

On the other side of the ledger, Western capital markets are far more developed and the Soviets more sophisticated in tapping them. Initiatives such as bond issues allow Moscow to expand its borrowing before running up against portfolio constraints and otherwise reducing access to additional funds and/or raising the cost of future borrowing. Soviet pragmatists would contend, however, that current conditions only serve to allow Moscow to get into bigger trouble faster.

Gorbachev's Current Initiatives

Soviet emphasis on concluding joint ventures with Western firms reflects these concerns and limitations. The deals, by forcing long-term Western involvement in enterprise decisionmaking and productive efficiency:

- Improve the likelihood for effective Soviet absorption of Western equipment and know-how.
- Increase the chances for increased exports of manufactured goods to the developed West.

- Minimize the drain on scarce hard currency by virtue of Western capital participation and agreements to repatriate profits in the form of products.

The saliency of joint ventures to the leadership's economic agenda is seen in the regime's willingness to bend or change the rules in order to attract Western investors to priority projects. Alternatively, Moscow's inability to allay Western concerns about the joint venture's access to raw materials and intermediate products, the hiring and firing of employees, and the repatriation of profits in hard currency highlight the economic barriers to economywide modernization using foreign investment.

Soviet interest in international organizations such as meetings of the General Agreement on Tariffs and Trade (GATT) and the International Monetary Fund (IMF) has strong political overtones in signaling Moscow's intentions to become a full member of the international economic and financial community. From an economic perspective, links to these organizations would improve foreign trade and financing decisionmaking and otherwise provide the framework for expanded exports of manufactured goods over the long term:

- Moscow is probably most interested in becoming a party to GATT rules and negotiations. Moscow's cooperation agreement with the European Community also reflects the desire to develop a better understanding of potential export opportunities.
- Discussions with the IMF and the World Bank are far more exploratory in nature. More than likely, the USSR is interested in developing a detailed appreciation of the costs and benefits of membership before making any formal approaches; there is no financial need to link up with the IMF at this time.

Beyond joint ventures and a new interest in international trade and financial organizations, however, Moscow's turn to the West is more show than go. By

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all indications, there is no leadership consensus supporting a major turn to the West at this time. Emphasis continues to be placed on domestic solutions in the belief that substantial increases in the quality and quantity of civilian products—both producer durables and consumer goods—will evolve from the implementation of ongoing programs to:

- Draw on the expertise and productive base of the defense sector.
- Reduce the barriers to the effective development and application of Soviet-designed production and process technologies.
- Decentralize enterprise decisionmaking and otherwise allow for increased enterprise control over the quality and quantity of inputs it receives.
- Alter the structure of incentives to better reward efficient enterprises and productive employees.
- Increase the supply of consumer goods and services by allowing for greater privatization of economic activity.

Its own reservations regarding the utility of relying more on imports notwithstanding, Moscow has not belittled the belief among Western governments that Western support for *perestroika* can be a profitable business. In a move somewhat reminiscent of the mid-1970s, Soviet negotiators are concluding a number of major credit agreements with Western bank consortiums, explicitly blessed by West European governments, to underwrite future Soviet purchases of Western technology and equipment for the USSR consumer goods sector. See the following tabulation on credit lines extended to the USSR:

	Millions US \$	
	Secured, April 1974- March 1976	Signed or Under Negotiation, 1988
Austria	304	
Canada	487	
France	3,095	1,900
Italy	1,917	775
Japan	1,648	2,000
UK	2,270	1,700
Federal Republic of Germany	1,334	1,700
Netherlands		250

While Moscow could well be lining up credit lines now to permit more flexibility in resource allocation decisions pertinent to the 13th Five Year Plan (1991-95), the spate of activity, size of the lines, and their explicit and highly publicized link to improving consumer welfare indicate the presence of a political agenda as well:

- There is no indication that Moscow is prepared to move quickly to place equipment orders against these credit lines.
- Unlike the credit lines of the mid-1970s, when credit competition among Western governments led to substantial interest rate subsidies, the recently concluded lines do not offer preferential financing (outside of the slight interest rate savings from the presence of government political and economic risk guarantees) or otherwise materially broaden the potential base for Soviet borrowing.

The Soviet initiative comes at a time of consideration by the US Congressional and executive branches of the propriety of restricting or monitoring credit flows to the USSR. Within this context, Moscow—in lining up large credit lines backed by Western political leaders—may have sought to steal a march on any attempt by the United States to develop an Alliance-wide consensus on the credit issue. More broadly, Moscow undoubtedly sought to use the credit issue to promote official Western support to Gorbachev's program of economic and social revitalization to the betterment of its larger foreign policy and national security objectives.

And the Road Not Taken

Gorbachev may be forced ultimately to turn to the West for help in transposing the Soviet economy and may buy time in the interim with substantial inflows of consumer goods. Such a decision would quickly become evident to Western analysts by virtue of the media attention to the signing of specific contracts and the like. This option, however, holds dangers that

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Gorbachev's predecessors did not have to face, making the choice much harder this time around. In many ways it would be a clear sign of leadership desperation:

- Unlike the situation in the 1970s, there is no guarantee that Moscow will be able to repay a marked increase in hard currency indebtedness. Barring export increases, the USSR would have to continually increase the level of annual borrowings if it were to maintain a flow of imported goods while servicing an ever-growing debt. It would be only a matter of years before the Soviet leadership would find itself potentially vulnerable to Western economic and political leverage.
- Western firms will want a significantly greater managerial involvement and Western physical presence within the Soviet Union as part of any agreements that meet Gorbachev's demands for Western technology and managerial know-how.
- Unlike the 1970s—when the Soviet leadership viewed expanded trade as a means of complementing a basically sound economic structure—turning to the West this time around will be perceived as a sign that the regime is incapable of fixing its economic problems on its own.

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Notes

Oil Ministry Looking for Increase in Investment Allocations

The lead article in a recent issue of the journal of the Soviet oil ministry indicated for the first time that allocations of capital investment for the oil sector are not adequate to maintain current levels of oil production. The article indicated that the investment requirements of the oil sector are sharply increasing because of the "depletion and falling productivity of many oilfields and the necessity of maintaining planned levels of production by the mass introduction of remote, low-quality oilfields with complicated geology and in unfavorable environmental locations."

The oil sector moved to a self-financing basis in January 1988. Apparently, the sector is having trouble finding the money to pay for its escalating equipment needs. The article indicated that, while state orders account for 94 percent of oil output in 1988, state orders for the equipment, materials, and instrumentation for use by the oil industry account for only 70 percent of the sector's needs. The plan to pay for the difference with profits is not working well because wholesale oil prices have remained low while oilfield equipment costs have risen sharply. In addition, the article asserted that the machine-building ministries, prices notwithstanding, are not capable of producing all the needed equipment because oilfield equipment is too "narrowly specialized."

Oil production, as indicated in the article, has fallen in recent months. Oil ministry officials may be trying to build a case for increasing investment allocations or, should oil output continue to slip, preemptively defending their performance by blaming the decline on equipment shortages. If the Soviets decide to increase equipment deliveries to the oil sector, imports from the West would probably increase because most Soviet oilfield equipment plants are reportedly already operating at or near capacity.

Economic Reform Schedule Revision

The reports on the Soviet draft plan and budget for 1989 indicate that the Soviet leadership has made some adjustments to the schedule for implementing various economic reforms. Comparison of the reform goals for 1987 and 1988 (see table) discloses these changes:

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Soviet Economic Reform: A Status Report

Reform	Major Purpose	1989 Goals	1988 Results	Final Objective
Enterprise self-financing	Enterprises will bear full economic responsibility for the results of their activity. Investment will be financed less through budget allocations and more through an enterprise's own resources and bank credits.	100 percent of industry and agriculture; "hope" to complete changeover of nonproduction sphere to same principles.	60 percent of volume of output in the economy.	Same as 1989 goals.
Regional/local self-financing	Republics and local government will have a greater role in forming their own budgets and will be expected to balance revenues and expenditures. Revenues will be formed from taxes levied on enterprises within the region or locale to fund social/economic development.	Estonia, Latvia, Lithuania, Belorussia, Moscow City, and the Tatar ASSR and Sverdlovsk Oblast (RSFSR).	Not yet introduced.	Expansion to unnamed regions.
Planning	Enterprises will produce a portion of their output in compliance with mandatory state orders and will be given greater latitude in determining the remainder.	All enterprises and associations. State orders are to make up an estimated 40 percent of industrial production.	State orders made up 86 percent of industrial production.	State orders are to "eventually" drop to 20 to 25 percent of total production.
Supply	Only "scarce" producer goods and supplies for state orders will continue to be rationed by the state. Other supplies will be distributed through a wholesale trade system that will allow free purchase and sale under direct contracts between providers and users.	Approximately 10 percent of total industrial production to operate under wholesale trade; 50 to 55 percent of sales through state supply networks or wholesale trade.	Over 4 percent of total industrial production operated under wholesale trade. Less than 20 percent of sales through state supply networks on wholesale trade.	Wholesale trade reform to cover more than 70 percent of sales through state supply networks by 1992. ^b

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Wages	Entire wage and salary structure in the production sector will be overhauled, but increases are dependent on an enterprise's ability to finance them and are tied to increases in labor productivity.	No announced goal. 1988 goal was 60 to 70 percent of the work force. (May not be expanded because of concern that wages are being increased more than increases in labor productivity.)	(We have no information.)	All industrial sectors by end of 1990.
Banking	Decentralizes bank decisionmaking somewhat and elevates the role of economic criteria in extending credit.	Codification of banking practice through new banking legislation.	Limited decentralization. Some flexibility in negotiating lending rates. Assumed role of liquidators in cases of insolvency.	After price reforms are implemented.
Foreign trade	Allows selected ministries and enterprises to engage directly in foreign trade and enter into joint ventures.	Unannounced.	Was to be 26 percent of all imports and 14 percent of all exports. (Implementation behind schedule.)	No date given.
Wholesale prices	Will be revised to better reflect resource scarcity and customer demands and will be based on contracts.	Not scheduled to be implemented.	Not scheduled to be implemented.	Industry, transportation, and communication by 1 January 1990; construction and agriculture by 1 January 1991.
Retail prices	Will be made more flexible and more fully reflective of supply and demand, probably resulting in higher prices for foods, rent, and consumer services.	None; to begin only after full public discussion and before 1991 (beginning of 13th Five-Year Plan).	Not scheduled to be implemented.	Whole economy, presumably including retail by 1991.

* This goal has been moved from 1990 to 1989. In 1987, the stated 1989 goal was 30 percent of sales through state supply networks operating on wholesale trade.

* This goal has been slightly reduced. In 1987, the stated 1992 objective was for wholesale trade to cover 80 percent of sales through state supply networks.

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- A substantial reduction in state orders.
- An accelerated introduction of wholesale trade in state supply networks for 1989—from a goal in 1987 of 30 percent of sales to a goal in 1988 of 50 to 60 percent of sales.
- An introduction in 1989 of regional and local self-financing in Estonia, Latvia, Lithuania, Belorussia, Moscow City, and the Tatar ASSR and Sverdlovsk Oblast in the RSFSR.
- An emphasis on selling shares and bonds to employees to provide an alternative source of investment funds for enterprises.
- An expansion of leasing arrangements both in agriculture and in industry.
- A deemphasis and possible curtailment of the state quality-control program (*gospriyemka*).

The most dramatic change is the intent to reduce state orders in industry by more than 50 percent in 1989 because state orders made up such a large volume of production in 1987. State orders made up 86 percent of industrial production in 1988, according to Gosplan Chief Yuriy Maslyukov, although they were initially designed to cover 50 to 70 percent of the total volume of output in the manufacturing industry and a slightly larger proportion in the raw material and fuel-energy industries. Concerned that output plans would not be fulfilled, ministries augmented the Gosplan-issued state orders. Many enterprises eagerly accepted them because they meant guaranteed supplies and sales. In his report to the Supreme Soviet on the 1989 plan, Maslyukov specified the percentages of state orders by sector for the coming year. From this information, we calculate that state orders are expected to drop to approximately 40 percent¹ of industrial production in 1989. This is also the figure used by Soviet economist Abel Aganbegyan at a conference on wholesale trade held in Moscow at the end of November 1988.

In 1988 the burdensome system of state orders stymied enterprise independence and slowed reform implementation. It may also have protected industry from major disruptions that could have occurred because enterprises were unprepared to conclude contracts on their own. It is not clear if enterprises are better prepared to do this in 1989. This time, ministries are constrained from coming to the rescue. In response to widespread complaints that ministries abused the state order system in 1988, an "interim provision" for 1989-90 was adopted that prohibits ministries from amending Gosplan-approved state orders and limits the categories of goods that can be included in them.

¹ In its summary of the draft plan and budget, TASS apparently mistakenly reported this number as 25 percent; the sector totals do not support this figure. The 25 percent probably refers to state orders for the machine-building sector.

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Viewpoint

The views expressed in the following article are the author's and do not necessarily represent a CIA consensus.

Untied Lending to the Soviet Union: A Perspective

The recent flurry of new credit lines offered the USSR has fueled the ongoing controversy over whether and how the West should "underwrite" *perestroika*. Some argue against any economic relations with the Soviet Union on the grounds that we have no guarantee that a "restructured" and hence economically stronger Soviet Union would pursue fewer policies at odds with those of the Western alliance. Some advocate restrictions only on lending to the Soviets to finance trade because such money enables Soviet leaders to postpone the reallocation of defense resources to pressing civilian needs. The greatest controversy, however, rages over "untied" lending; that is, loans provided with no Soviet commitments to any specific purchases and possibly provided with government subsidization. The size of these funds is perceived by some as well above what is needed to finance Soviet imports and to service debt, thus providing Moscow with substantial discretionary funds that can be used to maintain its overseas empire and fund activities that are inimical to Western interests.

Underwriting Perestroika

Gorbachev recognizes that the West has a role to play in his ambitious plans for the Soviet economy, but he, nonetheless, hopes to modernize largely from within. Unlike past regimes, this new Soviet leadership is aware that substantial imports of Western machinery and equipment are not a panacea, especially if the internal mechanisms are not in place to assimilate

effectively and diffuse such imports. The Soviets currently bemoan the excessive amounts of uninstalled imported equipment lying about in warehouses and the substantial annual interest payments that resulted from those hasty purchases. Moreover, Gorbachev remains loath to increase further Soviet dependence on Western governments, companies, and bankers, a view no doubt reinforced by the East European debt crises in the early 1980s and the USSR's financial picture, which is less certain because of low energy earnings and a depreciating US dollar.

Thus, foreign credits—whether tied or untied, subsidized by Western governments or unsubsidized—are not at present slated to play a big role in modernizing the Soviet economy, a fact borne out by current Soviet financial behavior:

- Moscow has not borrowed much in recent years: indeed about three-quarters of the \$19 billion rise in Soviet gross debt between 1984 and 1987 is the result of exchange rate movements, not new borrowing. In 1987, for example, Soviet repayments exceeded new borrowings, with the entire increase in gross debt resulting from the appreciation of non-dollar currencies.

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- To the extent it is borrowing, Moscow is looking increasingly to tied credits. Beginning last year Moscow started turning to government-backed lines of credit geared toward project financing, and the new lines are linked primarily to purchases of machinery and equipment for the production of consumer goods. Moscow's stepped-up use of untied, general purpose borrowing in the mid-1980s was driven largely by the low interest rates accompanying the loans, not a heavy demand for unrestricted cash.
- The attractive terms accorded Moscow when it borrows are a reflection of its creditworthiness, the economies of scale inherent in large loans, and the lack of alternative borrowers. At present, Western governments are not subsidizing loans to the Soviet Union and are adhering to OECD guidelines on interest rates for lending with official backing.

Funding the Overseas Empire

Foreign credits also play a small role in propping up regimes from Hanoi to Managua. The Soviet Union is experiencing considerable difficulty in maintaining its global commitments, to be sure, as resource constraints make it tougher to meet competing demands at home and abroad. A restraint on total lending to the USSR would have an adverse impact on its ability to support its overseas empire. But most Soviet support is in the form of its own domestically produced products, particularly arms and energy, that are provided to client states either free of charge or with overly attractive financing terms.

Untied Western cash could—and to some extent probably does—work its way through the international financial network and end up financing overseas activities. Moscow goes to great lengths, however, to reduce actual hard currency outlays. Our annual balance-of-payments estimates for the Soviet Union consistently show "errors and omissions"—which we believe encompass hard currency expenditures on overseas activities—averaging less than \$4 billion. This order of magnitude seems reasonable when one considers that the US budget for 1986 lists US expenditures on the conduct of foreign affairs and foreign information and exchange at \$3.3 billion.

Given Moscow's more austere approach to funding its missions abroad and the soft nature of Soviet expenditures in much of the Third World, we are comfortable with the statement that actual hard currency costs fall in the \$3 billion range or less.

Soviet aid to Cuba is a good case in point. Estimated annual economic aid to Cuba is on the order of \$5 billion, but only \$300-400 million of this is hard currency ending up in Cuban coffers. This is the cash we believe Moscow forwards to Havana as a result of selling oil destined for Cuba in Western oil markets.

Money is fungible, and it is highly unlikely that the elimination of untied credits, while not cutting overall lending, would impact on Moscow's foreign ventures in any way. At best such a loss would prove an "inconvenience." The Soviets could easily compensate for a loss of untied funds by stepping up their use of supplier credits. The switch would not be without costs because Moscow could no longer easily tap the Eurocurrency market and would have to document imports before receiving credits. But Western financial institutions would, over the medium term, very likely develop mechanisms allowing for the easier provision of "tied" credits to the USSR. In conjunction, the Soviets could readily finance overseas activities from current hard currency inflows, gold reserves, or assets on deposit in Western banks. Total hard currency inflows from all sources—the pool that Moscow can draw from—have averaged about \$40 billion since 1983. In addition, Moscow has gold reserves worth well over \$30 billion at current market prices and about \$14 billion on deposit in Western banks.

A Final Caveat

None of this is to imply that the Western alliance does not have a stake in coordinating an economic strategy to deal with Moscow's new economic overtures. Nor does it mean that the West could not improve upon its efforts to monitor Soviet financial flows. But these

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measures should be undertaken with the understanding that the West will not "make or break" Gorbachev's economic program. Gorbachev recognizes that his enormous economic problems are domestic in origin and require largely domestic solutions.

Attempts to impose further restrictions on world capital markets are proving divisive within the Western alliance, and, for the most part, they concentrate on a rather small share of Moscow's current economic dealings with the West. This year the Soviet Union's imports from the West are likely to top the \$25 billion mark. To date Moscow has also completed over 90 joint-venture contracts with Western firms and is negotiating additional deals—some reportedly worth billions of dollars. Such "mutually beneficial, nonstrategic" transactions provide Gorbachev with far more flexibility to cope with hard choices than do current low levels of untied credits

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